



DATE: January 27, 2010

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THROUGH: RENENA SMITH, Budget Director *RS*
Budget and Management Studies Division

FROM: BOB KOURY, Principal Internal Auditor *Bob Koury*
Budget and Management Studies Division - Internal Audit

SUBJECT: CONTRACT AUDIT – AIRPORT AND THE HERTZ CORPORATION – FINAL
AUDIT REPORT

At the request of the City's Director of Aviation, the Concession and Facility Lease Agreements between the Airport and The Hertz Corporation were audited by the City's Principal Internal Auditor, in accordance with AO 1-12 and Government Auditing Standards. Attached is the Final Audit Report.

Internal Audit will perform a follow-up audit six to twelve months after this report is issued to verify that each recommendation has been implemented or that the issue documented in the finding has been resolved in a manner that addresses the weakness or risk identified. The follow-up audit is performed in accordance with AO 1-12 and Government Auditing Standards.

We wish to thank the Airport and The Hertz Corporation staff for their assistance provided during the course of this audit. If you have any questions, please contact Bob Koury, Principal Internal Auditor, at 559-621-7072.

Attachment

cc: Ashley Swearengen, Mayor
City Councilmembers
Andrew T. Souza, City Manager
Bruce Rudd, Assistant City Manager
Nicole Zieba, Deputy City Manager
James Sanchez, City Attorney
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INTERNAL AUDIT

FINAL AUDIT REPORT

Contract Audit Airport and The Hertz Corporation

Performed By:
Bob Koury, Principal Internal Auditor
Budget and Management Studies Division – Internal Audit

Issued on January 27, 2010

Executive Summary

Overall, both the Airport and Hertz Corporation are commended for their efforts and performance related to the compliance, record-keeping and financial reporting under both the Concession and Facility Lease Agreements. No significant audit findings were noted as a result of this audit.

Internal Audit has, however, identified a few areas during the audit and specific to the Contract language and actual performance that need to be addressed between both parties and formally documented for clarification and compliance purposes as these Contracts proceed forward between the Airport and The Hertz Corporation.

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INTRODUCTION

Background

The Fresno Airport has two current Agreements with The Hertz Corporation for rental car services. The Restated Concession Agreement was effective on April 1, 2009, the "Date of Beneficial Occupancy" (DBO) and continues until August 31, 2014. The Extended and Restated Service Facility Lease Agreement was effective on September 1, 2008, the DBO, and continues until January 1, 2029.

Audit Objectives

The primary audit objectives of this contract audit were to determine and provide assurances that:

- ▶ The Contractor has established and maintains an adequate system of internal controls to assure that all Airport monies are received, accounted for, documented, deposited and accurately reported;
- ▶ Both Contractor and Airport responsibilities, as stipulated in the Contracts, have been adequately complied with by both parties; and
- ▶ All applicable laws, regulations, policies and procedures have been adequately complied with by the Contractor and Airport in the performance of these Contracts.

Audit Scope and Methodology

At the request of the City's Director of Aviation, the Concession and Facility Lease Agreements between the Airport and The Hertz Corporation were recently audited by the City's Principal Internal Auditor, in accordance with AO 1-12 and Government Auditing Standards. The audit was conducted during November and December 2009.

To accomplish our audit objectives, we thoroughly reviewed the Airport and Hertz Corporation Contracts; reviewed available and applicable documents to gain an understanding of The Hertz Corporation rental car and record-keeping and financial reporting processes; and tested applicable and sufficient records in order to form conclusions on the adequacy and accuracy of such records for audit purposes. We performed other audit procedures as considered necessary under the circumstances.

During the course of the audit, the Principal Internal Auditor communicated audit findings via email with both Airport and Hertz Corporation staff, as considered appropriate. An Audit Exit Meeting was held with both the Airport and Hertz Corporation Management staff on January 6, 2010, to discuss all audit findings and proposed recommendations included in this report.

Conclusion

Overall, both the Airport and Hertz Corporation are commended for their efforts and performance related to the compliance, record-keeping and financial reporting under both the Concession and Facility Lease Agreements. No significant audit findings were noted as a result of this audit.

However, Internal Audit did identify a few areas and provisions specific to the Contracts that need to be addressed between both parties and formally documented for clarification and compliance purposes as these Contracts proceed forward between the Airport and The Hertz Corporation.

REPORT SECTIONS – AUDIT RESULTS AND RECOMMENDATIONS

I. Security Deposits and Insurance Requirements

Security Deposits

Section 604 of the Airport/Hertz Facility Lease Agreement required a Security Deposit in an amount equal to three months of the Company's estimated Rent, pursuant to the Lease. The Security Deposit of \$19,802 was established per Bond SUR0001570, in compliance with this Section of the Facility Lease Agreement.

Section 408 of the Airport/Hertz Concession Agreement required a Security Deposit equal to one-fourth (25%) of the Company's Minimum Annual Guarantee Fee (MAG). The MAG as of April 1, 2009, was \$497,045, thus requiring a Security Deposit in the amount of \$124,262 (25% x \$497,045) also effective April 1, 2009. However, upon testing this requirement during the audit, it was noted that the current Security Deposit (Bond SUR0001571) under this Agreement was only \$100,000, i.e. "under-secured" for the period 4/1/09 through 11/19/09 by approximately \$24,262.

The Airport staff requested from Hertz Corporation an updated and increased Security Deposit for the Restated Concession Agreement in the amount of \$124,262. On December 9, 2009, Hertz Corporation formally communicated to Airport staff the appropriate increase in the Security Deposit, via a Bond "Rider" effective November 20, 2009, and also extended the bond term to October 31, 2010.

Insurance Requirements

When comparing the "Certificate of Liability Insurance" dated 9/10/09 with both Sections 603 of the Concession Agreement and Section 903 of the Facility Lease Agreement, the following exceptions were noted:

"Commercial General Liability" - The "General Aggregate" amount should be \$2,000,000 - only \$1,000,000 per Certificate. The Facility Lease Agreement, Section 903, also required "Pollution Liability Insurance" of not less than \$1,000,000 each occurrence and \$2,000,000 General Aggregate. There was no coverage for "Pollution Liability" included on the "Certificate of Liability Insurance" dated 9/10/09.

Also, per the Agreements, *"The General Liability, Automobile & Pollution Liability insurance policiesshall name the City of Fresno, its officers, officials, employees, agents and volunteers as an additional insured"*. The 9/10/09 Certificate of Liability Insurance only included General Liability as naming City of Fresno, etc., as additional insured, i.e. Automobile and Pollution Liability not included.

Upon notification of the above findings by Internal Audit with Airport staff, they immediately requested from Hertz Corporation a corrected "Certificate of Liability Insurance" (COI) to

address the above noted audit findings. A revised COI was received on 11/23/09; however, it still did not address the General Aggregate issue (remained at \$1,000,000 versus \$2,000,000), and only General Liability is naming City of Fresno as additional insured but not Automobile and Pollution Liability.

Audit Recommendation

1. Airport and Hertz Corporation Management should jointly discuss and document their agreement as to the appropriate amounts for Security Deposits and Insurance Coverage, related limits and additional insured via a "side letter" signed by both parties for future reference and/or audit purposes.

Airport Management and The Hertz Corporation Response to Recommendation 1

The Department and Hertz generally concur with the recommendation. As Internal Audit has indicated, the Department and Hertz have already agreed upon a surety bond amount in concordance with the terms of the contract. Additionally, Hertz has increased the dollar value of the bond to match the agreed upon amount. In the matter of the insurance limits and beneficiaries, Hertz has already made adjustments to reflect insurance levels specified in the contract. The Department continues to work with Hertz and the City's Risk Management Division to resolve the remaining insurance issues.

II. Tenant Rental Car Gross Receipts (Revenues) and Monthly Reports

Per the attached copy of the "Tenant Rental Car Gross Receipts Report" (Exhibit D) from the City/Hertz Concession Agreement, item number 2 states: *"Attach daily or weekly reports of sales for report period, prepared pursuant to lease."* During the audit, it was noted that no daily or weekly reports of sales were provided to the Airport by Hertz. These supporting records would assist the Airport staff in their review and verification process of each month's reported rental car revenues on an ongoing basis.

An attempt was also made by Internal Audit to ensure that all "Gross Revenue" items identified in the City/Hertz Concession Agreement (Items A – N on pages 5 & 6 of the Agreement) are, in fact, being accounted for and remitted to the Fresno Airport on a monthly basis. This procedure consisted of trying to compare the selected sample "Final Concessionable Revenue Reports" line items to Items A – N on pages 5 & 6 of the Agreement. Due to the various acronyms and abbreviated revenue line items listed on the Concessionable Revenue Reports, and without a response from either Hertz or the Airport staff as to an adequate explanation of each line item, Internal Audit was not able to verify that all rental car revenues are, in fact, being accounted for and remitted to the Airport, other than in total alone.

In addition, Section 403 A. (last sentence) and subsection 1. states: *"At a minimum, the Statement shall identify the following by separate line item: Gross Revenues for the preceding calendar month itemized to identify revenues earned in each of the categories specified in the Gross Revenues definition.."* This requirement was not completed by Hertz

in the preparation and submission of their Monthly Statement of Rental Car Revenues.

Audit Recommendation

2. Airport and Hertz Corporation Management should jointly discuss and document their agreement as to what monthly detailed revenue records are appropriate and necessary for the Airport in order to adequately account for, and report on, all monthly rental car receipts collected and remitted to the Airport by the Hertz Corporation. The results from the implementation of this recommendation should be documented via a "side letter" signed by both parties for future reference and/or audit purposes.

Airport Management and The Hertz Corporation Response to Recommendation 2

The Department and Hertz concur with this recommendation. The Department will meet with Hertz to agree upon the information that needs to be reported and the timing for the submission of that information. Conclusions from that meeting will be documented in a "side letter" to the existing agreement. Such a "side letter" may need to involve all rental car companies that operate at the Airport, as all the rental car company agreements contain the language and attachments identified in this recommendation.

III. 10% Concession Recovery Fee

Per Section 401 D. of the City/Hertz Concession Agreement: "*.....The Annual Concession Fees shall be the greater of (a) the Percentage Fee, a sum equal to ten percent (10%) of the Company's Gross Revenues, or (b) the Minimum Annual Guarantee (MAG).*" Under Article I - Definitions, Page 3 of the same Agreement, "Concession Recovery Fee" is defined as "*Means any amount that Company charges its customers to recover the amount of Annual Concession Fee paid by the Company under this Agreement, which charge should be clearly and separately stated on a customer's invoice and shall not be referred to as a tax.*"

Based on the results of our audit procedures and sample testing of the Concession Recovery Fee calculations by the Hertz Corporation for the audit period, it is concluded that all Concession Recovery Fees at 10% of the Company's Monthly Gross Rental Car Revenues have been appropriately collected and remitted to the Airport, in accordance with the Airport/Hertz Contract.

IV. CPI Adjustment – Service Facility and Common Use Area Rent

Per Section 602 C. of the Service Facility Lease Agreement and Section 402 C. of the Concession Agreement: "*.....Rent will be adjustedbased on the annual percentage change in the CPI-U Index. However, in no event will the annual adjustment result in Rent being less than the amount charged during the prior contract year or more than two percent (2%) above the amount charged during the prior contract year.*"

As defined in both City/Hertz Agreements, the CPI-U Index *"means the Consumer Price Index for San Francisco All Urban Consumer, Base Year 2009 or the successor of that index....."*, which is not stipulated in the Agreements. However, the CPI Index that was used by the Fresno Airport for the annual adjustment to the Service Facility and Common Use Area rent effective September 1, 2009, was the "Consumer Price Index – Urban Wage Earners and Clerical Workers".

With the 2% cap language in the Agreements, the CPI used by the Airport for the September 1, 2009 had no effect on the rent adjustment since it was held to the 2% increase amount. However, the usage of the CPI-U Index by the Airport, which is different than the CPI-U Index cited in the City/Hertz Agreements, should still be addressed for any future CPI rental adjustment calculations.

Audit Recommendation

3. Airport and Hertz Management should jointly discuss and resolve this audit finding to both party's satisfaction and concurrence. If joint concurrence results in the approval of the CPI-U Index "Consumer Price Index – Urban Wage Earners and Clerical Workers" being used by the Airport for the adjustment of the annual rent calculation, then the City/Hertz Agreements should be amended accordingly and then be formalized via a "side letter" signed by both parties.

Airport Management and The Hertz Corporation Response to Recommendation 3

The Department and Hertz agree with this recommendation. Staff has already recalculated the previous year's rent adjustments using the "Consumer Price Index – San Francisco All Urban Consumer" (there was no change from the dollar amounts of the rental increases calculated using the "Consumer Price Index – Urban Wage Earners and Clerical Workers" due to the 2 % cap language in the contract). Going forward, staff will use the Consumer Price Index – San Francisco All Urban Consumer" for rent adjustment calculation purposes.